SIMPLIFICATION OF TAX RULES RELATING TO EMPLOYEE BENEFIT PROGRAMS MAINTAINED BY CHURCHES

(S. 2902, The Church Retirement Benefits Simplification Act)

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS
AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE

of the

SENATE COMMITTEE ON FINANCE

on August 3, 1990

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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CONTENTS

	Page
INTRODUCTION	1
I. SUMMARY	2
II. PRESENT-LAW TAX RULES	3
A. Overview of Qualified Plans	3
B. Tax-Sheltered Annuity Programs	4
C. Sanction for Failure to Meet Qualification Rules	5
D. Special Rules Applicable to Church Plans	5
III. DESCRIPTION OF S. 2902	9
A. Consolidation and Modification of Rules Relating to Church-Maintained Qualified Retirement Plans	9
B. Retirement Income Accounts of Churches	11
C. Tax-Sheltered Contracts Purchased by Churches	11
D. Modification of Distribution Requirements	13
E. Modification of Required Beginning Date for Distributions	13
F. Exclusion of Ministers from Non-Discrimination Requirements	13
G. Aggregation Rules Not to Apply to Churches	14
H. Qualified Retirement Contributions to Include Voluntary Contributions Pursuant to Church Plans	14
I. Self-Employed Ministers Treated as Employees for Purposes of Certain Welfare Benefit Plans	14
J. Deductions for Contributions by Certain Ministers to Retirement Income Accounts	14
K. Modification of Rules for Plans Maintained by More than One Employer	15

L. Expansion of Definition of Church for Purposes of Rules Relating to Certain Deferred Compensation Plans..... 15

M. Modification to Health Benefits Accounts in Church Plans..... 15

N. Modification of Rule Relating to Investment in Contract..... 15

O. Modification of Rule Relating to Elective Deferral Catch-Up Limitation for Retirement Income Accounts..... 16

P. Church Plans May Annuitize Benefits..... 16

Q. Church Plans May Increase Benefits..... 16

R. Exemption for Church Plans from Non-Discrimination Rules Applicable to Self-Insured Medical Accounts..... 16

IV. ISSUES RELATING TO S. 2902..... 18

INTRODUCTION

The Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service of the Senate Committee on Finance has scheduled a public hearing on August 3, 1990, to review the Internal Revenue Code rules relating to private pension plans and possible options for simplification of pension plan rules. The hearing will focus on S. 2901,[1] the Employee Benefits Simplification Act, introduced by Senator Pryor and others on July 25, 1990, and S. 2902, the Church Retirement Benefits Simplification Act, also introduced by Senator Pryor on July 25, 1990.

This document,[2] prepared by the staff of the Joint Committee on Taxation, provides a discussion of S. 2902 and the issues relating to modification of the Federal income tax rules relating to church-maintained retirement and employee benefit plans. Part I is a summary. This is followed by a discussion of the present-law Federal tax rules regarding tax-qualified plans, and, in particular, plans maintained by churches (Part II), a description of S. 2902 (Part III), and a discussion of issues relating to church plans (Part IV).

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[1] For a description of S. 2901, see Joint Committee on Taxation, Simplification of Present-Law Tax Rules Relating to Qualified Pension Plans (S. 2901, the Employee Benefits Simplification Act) (JCS-24-90), August 3, 1990.

[2] This document may be cited as follows: Joint Committee on Taxation, Simplification of Tax Rules Relating to Employee Benefit Programs Maintained by Churches (S. 2902, the Church Retirement Benefits Simplification Act) (JCX-24-90), August 3, 1990.

I. SUMMARY

A plan of deferred compensation that meets the qualification standards of the Internal Revenue Code (a qualified plan) is accorded special tax treatment under present law. Similar tax treatment is accorded to tax-sheltered annuity programs. The employer maintaining the plan is entitled to a deduction (within limits) for contributions to a plan even though an employee is not required to include the benefit in income until it is distributed.

The rules relating to qualified plans and tax-sheltered annuities are generally designed to encourage employers to establish such plans (particularly for their rank-and-file employees) and to protect employees' rights under the plans.

Unless a church elects otherwise, plans maintained by churches or church-related organizations are exempted from the coverage, vesting, funding, and certain other requirements contained in the Employee Retirement Income Security Act of 1974 (ERISA). With respect to non-electing church plans, such rules in effect before the enactment of ERISA apply. In addition, several special rules apply to such plans. With respect to welfare benefit plans, church plans generally are subject to the same rules that apply to plans maintained by other employers.

S. 2902 would consolidate and modify rules relating to church-maintained qualified retirement plans, tax-sheltered annuity plans, and welfare benefit plans. In general, the bill would expand the existing church plan exemption in the qualified plan area. Issues exist with respect to whether the present-law exemption is warranted and, if warranted, whether the exemption should be expanded in the manner contemplated by the bill.

II. PRESENT-LAW TAX RULES[3]

A. Overview of Qualified Plans

A plan of deferred compensation that meets the qualification standards of the Internal Revenue Code (a qualified plan), is accorded special tax treatment under present law. Employees do not include qualified plan benefits in gross income until the benefits are distributed even though the plan is funded and the benefits are nonforfeitable. Tax deferral is provided under qualified plans from the time contributions are made until the time benefits are received. The employer is entitled to a current deduction (within limits) for contributions to a qualified plan even though an employee's income inclusion is deferred. Contributions to a qualified plan are held in a tax-exempt trust.

The qualification standards and related rules governing qualified plans are designed to ensure that qualified plans benefit an employer's rank-and-file employees as well as highly compensated employees. They also define the rights of plan participants and beneficiaries and provide some limit on the tax benefits for qualified plans.

Qualified plans are broadly classified into two categories, based on the nature of the benefits provided: defined contribution plans and defined benefit pension plans.

Under a defined benefit pension plan, benefit levels are specified under a plan formula. For example, a defined benefit pension plan might provide a monthly benefit of $10 for each year of service completed by an employee. Benefits under a defined benefit pension plan also may be specified as a flat or step-rate percentage of the employee's average compensation or career compensation. Benefits under a defined benefit pension plan are funded by the general assets of the trust established under the plan; individual accounts are not maintained for employees participating in the plan.[4]

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[3] This document generally is limited to a discussion of the Internal Revenue Code rules relating to tax-qualified retirement plans. In addition to the rules in the Internal Revenue Code, the labor law provisions of the Employee Retirement Income Security Act of 1974 (ERISA) contain extensive rules regarding employee benefit plans. For a more detailed discussion of the qualification rules, see Joint Committee on Taxation, Present-Law Income Tax Rules Relating to Qualified Pension Plans (JCS-9-90), March 22, 1990.

[4] Individual accounts may be maintained for after-tax
(Footnote continued)

Benefits under defined contribution plans are based solely on the contributions (and earnings thereon) allocated to separate accounts maintained for each plan participant. There are several different types of defined contribution plans, including money purchase pension plans, target benefit plans, profit-sharing plans, stock bonus plans, and employee stock ownership plans (ESOPs).

B. Tax-Sheltered Annuity Programs

Certain eligible employers may maintain tax-deferred annuity plans (sec. 403(b)). These plans provide tax-sheltered retirement savings for employees of public education institutions and employees of certain tax-exempt organizations (including churches and certain organizations associated with churches) that are described in section 501(c)(3). In addition to tax-deferred annuities, alternative funding mechanisms under section 403(b) include custodial accounts invested in mutual fund shares (sec. 403(b)(7)) and church-maintained retirement income accounts (sec. 403(b)(9)).

Tax-sheltered annuity programs may be funded through either employer contributions or salary reduction amounts. Employer contributions are excluded from the employee's income for the taxable year to the extent they do not exceed the employee's exclusion allowance. The amount of salary reduction is limited to an annual maximum (sec. 402(g)). In addition, the total amount of contributions is subject to the limitations on contributions generally applicable to defined contribution plans (sec. 415(c)).

Tax-sheltered annuity programs must meet certain nondiscrimination rules (sec. 403(b)(12)). Plans with nonelective employer contributions must meet the minimum participation requirements (sec. 401(a)(26)), minimum coverage requirements (sec. 410), and the nondiscrimination requirements relating to contributions and benefits (secs. 401(a)(4) and (5)). In addition, if employer contributions are used to match employee contributions, the program must meet the requirements generally applicable to matching plans (sec. 401(m)). Tax-sheltered annuity programs must also meet the requirements relating to the limitation on the amount of compensation upon which contributions and benefits may be based (sec. 401(a)(17)).

A tax-sheltered annuity program is required to meet an eligibility test that is met if all nonexcludable employees of the organization may elect to have the employer make

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[4](continued)
employee contributions made to a defined benefit pension plan.

contributions of more than $200 pursuant to a salary reduction agreement if any employee of the organization may elect to have the organization make contributions for such contracts pursuant to such agreement.

C. Sanction for Failure to Meet Qualification Rules

If a plan fails to meet the qualification standards, then the special tax benefits for qualified plans do not apply, and benefits and contributions are taxed under normal income tax rules. Similar rules apply in the case of an employer who fails to meet the rules relating to tax-sheltered annuities. In general, if a plan fails to meet the qualification standards, then contributions to the plan are includible in employees' gross income when such contributions are no longer subject to a substantial risk of forfeiture (secs. 402(b) and 83). Amounts actually distributed or made available to an employee are generally includible in income in the year distributed or made available under the rules applicable to taxation of annuities (sec. 72). Special sanctions apply in the case of failure to meet certain nondiscrimination rules (e.g., sec. 410).

An employer is generally not entitled to a deduction for contributions to a nonqualified plan until the contributions are includible in an employee's gross income.

D. Special Rules Applicable to Church Plans

In general

A church plan is a plan established and maintained for employees (or their beneficiaries) by the church or by a convention or association of churches that is exempt from tax under section 501 (sec. 414(e)). Church plans include plans maintained by an organization, whether a corporation or otherwise, that has as its principal purpose or function the administration or funding of a plan or program for providing retirement or welfare benefits for the employees of the church or convention or association of churches (sec. 414(e)(3)(A)).[5]

Certain church plans are exempt from the coverage, vesting, funding and fiduciary requirements of ERISA. Church plans may waive this exemption by election (sec. 410(d)). Electing plans become subject to all section 401(a) qualification requirements, Title I of ERISA, the excise tax

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5 With respect to certain provisions (e.g., the exemption for church plans from nondiscrimination rules applicable for tax-sheltered annuities), the more limited definition of church under the employment-tax rules applies (secs. 3121(w)(3)(A) and (B)).

on prohibited transactions (sec. 4975), and participate in the termination insurance program administered by the Pension Benefit Guaranty Corporation.

Qualification requirements

Minimum coverage and participation rules.--Church plans are subject to the minimum participation rule that requires each plan to cover the lesser of 50 employees or 40 percent of all employees. However, non-electing plans are not subject to the minimum participation and coverage requirements contained in section 410. Instead these plans must meet pre-ERISA coverage requirements (sec. 401(a)(3) as that section was in effect on September 1, 1974).[6]

Nondiscrimination in contributions and benefits.--Church plans are subject to rules that require that a plan not discriminate in favor of highly compensated employees (sec. 401(a)(4) and (5)). In addition, such plans are subject to the rules relating to the integration of benefits with social security (sec. 401(l)) and to the rules relating to top-heavy plans (sec. 416).

Vesting.--Non-electing church plans are not subject to the vesting rules of section 411. However, such plans must meet pre-ERISA vesting rules (secs. 401(a)(4) and (7) as in effect on September 1, 1974). In general, under pre-ERISA law, participants must have become fully vested upon attainment of normal retirement age, or upon the termination of the plan (to the extent funded) whether the termination was partial or otherwise.

Maximum limitation on contributions and benefits.--The limitation on contributions and benefits that apply to qualified plans also apply to church plans (sec. 415). However, the rules in effect prior to the Tax Reform Act of 1986 relating to early or late commencement of benefits apply. In addition, church plans are subject to the requirements relating to the limitation on the amount of

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6 Prior to ERISA, section 401(a)(3) required that a plan benefit either (1) 70 percent or more of all employees, or 80 percent or more of all eligible employees if at least 70 percent or more of all the employees were eligible for the plan, or (2) such employees as qualify under a reasonable nondiscriminatory classification as determined by the Secretary. For purposes of this pre-ERISA coverage test, the following employees could be excluded from consideration: (1) employees who have not been employed for at least 5 years, (2) employees whose customary employment is not more than 20 hours in any one week, and (3) employees whose customary employment is not more than 5 months in any calendar year.

compensation upon which contributions and benefits may be based (sec. 401(a)(17)).

Deductions.--The limitations on an employer's deduction for contributions to a qualified plan are, in large part, irrelevant in the case of a church plan because churches are tax-exempt organizations.

Funding.--Non-electing church plans are exempt from the minimum funding requirements (sec. 412(h)(4)). However, such plans must meet certain pre-ERISA requirements (sec. 401(a)(7) as in effect on September 1, 1974). These requirements do not require a particular funding method.

Distributions.--In general, distributions from church plans are subject to the present-law distribution rules applicable to plans maintained by nonchurch employers. However, an exception applies with respect to the definition of a qualified domestic relations order (sec. 414(p)(11)). In addition, certain church plans (described in sec. 3121(w)(3)(A) or (B)) are not required to begin benefits by April 1 of the year following the year in which an employee attains 70-1/2, if the employee has not retired.

Tax-sheltered annuities.--Tax-sheltered annuity programs maintained by churches generally are not subject to the nondiscrimination rules applicable to such programs (sec. 403(b)(1)(D)). For purposes of this exemption, a church is defined as a church or church controlled organization as defined for certain employment tax purposes. For these purposes, a church includes a convention or association of churches, or an elementary or secondary school that is controlled, operated or principally supported by a church or by a convention or association of churches (sec. 3121(w)(3)(A)). A church controlled organization is defined as a tax-exempt organization described in section 501(c)(3), other than one that (1) offers goods, services or facilities for sale (except incidentally) to the general public, unless such sale is at a nominal charge substantially less than cost, and (2) normally receives more than 25 percent of its support from either governmental sources or from receipts from admissions or sales of goods, services or facilities (sec. 3121(w)(3)(B)).

Rules relating to welfare benefit plans

The exclusions from income related to employer-provided welfare benefits are available to employees of churches (e.g., sec. 106). In addition, the requirements relating to the particular exclusion (including applicable nondiscrimination requirements) generally apply to welfare benefit plans maintained by churches. Thus, for example, a plan maintained by a church must meet the nondiscrimination rules relating to self-insured medical plans (sec. 105(h)),

group legal services plans (sec. 120), cafeteria plans (sec. 125), education assistance plans (sec. 127), and dependent care assistance programs (sec. 129). The nondiscrimination rules (sec. 505) that apply to voluntary employees' beneficiary associations (VEBAs) also apply to VEBAs maintained by churches.

Church plans generally are not subject to the health care continuation rules (sec. 4980B). In addition, certain church plans are not subject to the nondiscrimination requirements applicable to group-term life insurance (sec. 79(d)). For purposes of the group-term life insurance rules, a church plan is defined as a plan maintained by a church organization described in section 501(c)(3) other than educational organizations above the secondary school level, hospitals, and other medical care related organizations.

III. DESCRIPTION OF S. 2902[7]

S. 2902 provides a general revision of the rules relating to church-maintained qualified retirement and welfare benefit plans. In addition, rules relating to employee annuity contracts and retirement income accounts maintained for the benefit of church employees are modified.

A. Consolidation and Modification of Rules Relating to Church-Maintained Qualified Retirement Plans

In general

The bill adds a new section 401A to the Code that defines a qualified church plan. If the requirements of new section 401A are met then the qualified church plan is treated as satisfying section 401(a) as well as all sections referred to therein.

Definition of qualified church plan

In general

In order to meet the requirements of section 401A, the plan must meet the definition of a church plan as set forth in section 414(e). In addition, the church that maintains the plan may not have elected (pursuant to section 410(d)) to waive the exemption from certain qualification requirements available to church plans (e.g., participation, vesting and funding rules).

Employee contributions and vesting

An employee's rights in his or her accrued benefit derived from his or her own contributions must be nonforfeitable. In addition, the vesting schedule of a qualified church plan must meet either a 10-year vesting schedule or a 5- to 15-year vesting schedule. A plan satisfies the 10-year vesting requirement if an employee who has at least 10 years of service has a nonforfeitable right to 100 percent of his accrued benefit derived from employer contributions. A plan meets the 5- to 15-year schedule if the vesting schedule meets the following:

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[7] S. 2902, the Church Benefits Simplification Act of 1990, was introduced by Senator Pryor on July 25, 1990.

Years of service:	Nonforfeitable percentage:
5	25
6	30
7	35
8	40
9	45
10	50
11	60
12	70
13	80
14	90
15 or more	100

Funding requirements

As under present law, a qualified church plan must meet the requirements of section 401(a)(7) as that section was in effect on September 1, 1974.

Additional requirements

A qualified church plan must meet the requirements of sections 401(a)(1), (2), (8), (9), (16), (17), (25), (27) and (30). In addition, the requirements of sections 401(b), 401(c), and 401(h) apply to such plans.

If the plan includes employees of an organization that is not a church, then either the plan or such organization (at the option of the plan) shall meet the requirements of sections 401(a)(3) and (a)(6) (as in effect on September 1, 1974), as well as sections 401(a)(4), 401(a)(5) and 401(m).

Definitions and special rules

Definition of church.--For purposes of section 401A, a church is defined as a church or a convention or association of churches, including organizations whose principal function is to fund or maintain a plan for churches (as described in sec. 414(e)(3)(A)). The definition of church also includes certain organizations described in section 414(e)(3)(B)(ii) (relating to certain tax-exempt organizations) other than (1) schools above the secondary level (other than those for religious training) or (2) health care organizations (including hospitals) that provide community service for inpatient care and where not more than 50 percent of total patient days are customarily assignable to certain categories of medical treatment.

Satisfaction of trust requirements.--A plan does not fail to meet section 401A merely because such plan is funded through an organization described in section 414(e)(3)(A)

rather than through a trust.

Failure of one organization to qualify.--If one or more organizations maintaining a church plan fails to satisfy the requirements of section 401A, the plan is not disqualified with respect to the other organizations maintaining the plan that meet such requirements.

Special rules relating to highly compensated and excludable employees.--For purposes of section 401A, no employee is considered an officer, shareholder or person whose principal duties consist of supervising the work of other employees if such employee during the year or the preceding year received compensation of less than $50,000 (indexed). In addition, certain employees covered by collective bargaining agreements (as described in section 410(b)(3)(A)) are excluded for purposes of section 401A.

Effective date

The provision of the bill that adds section 401A generally is effective for years beginning after December 31, 1989. The vesting provision is effective for years beginning after December 31, 1992.

No regulation or ruling under section 401(a) issued after December 31, 1989, shall apply to a qualified church plan unless such regulation or ruling is specifically made applicable to such plans.

A church plan (within the meaning of section 414(e)) shall not be deemed to have failed to satisfy the applicable requirements of section 401(a) for any year beginning prior to January 1, 1990.

B. Retirement Income Accounts of Churches

Under present law, retirement income accounts (described in sec. 403(b)(9)) maintained by certain churches are treated as tax-deferred annuities. The bill modifies certain rules relating to such accounts. First, the bill allows certain controlled organizations (described in sec. 414(e)(3)(B)(ii)) that are exempt under section 501 to maintain such accounts. Second, the bill provides that certain ministers (including self-employed ministers) are treated as employees for purposes of the rules relating to retirement income accounts.

Effective date.--The provision is generally effective for years beginning after December 31, 1989. A church plan (within the meaning of sec. 414(e)) shall not be deemed to have failed to satisfy the applicable requirements of section 403(b) for any year beginning prior to January 1, 1990.

C. Tax-Sheltered Contracts Purchased by Churches

Years of service:	Nonforfeitable percentage:
5	25
6	30
7	35
8	40
9	45
10	50
11	60
12	70
13	80
14	90
15 or more	100

Funding requirements

As under present law, a qualified church plan must meet the requirements of section 401(a)(7) as that section was in effect on September 1, 1974.

Additional requirements

A qualified church plan must meet the requirements of sections 401(a)(1), (2), (8), (9), (16), (17), (25), (27) and (30). In addition, the requirements of sections 401(b), 401(c), and 401(h) apply to such plans.

If the plan includes employees of an organization that is not a church, then either the plan or such organization (at the option of the plan) shall meet the requirements of sections 401(a)(3) and (a)(6) (as in effect on September 1, 1974), as well as sections 401(a)(4), 401(a)(5) and 401(m).

Definitions and special rules

Definition of church.--For purposes of section 401A, a church is defined as a church or a convention or association of churches, including organizations whose principal function is to fund or maintain a plan for churches (as described in sec. 414(e)(3)(A)). The definition of church also includes certain organizations described in section 414(e)(3)(B)(ii) (relating to certain tax-exempt organizations) other than (1) schools above the secondary level (other than those for religious training) or (2) health care organizations (including hospitals) that provide community service for inpatient care and where not more than 50 percent of total patient days are customarily assignable to certain categories of medical treatment.

Satisfaction of trust requirements.--A plan does not fail to meet section 401A merely because such plan is funded through an organization described in section 414(e)(3)(A)

The bill modifies several rules relating to tax-deferred annuity contracts purchased by churches. The first modification relates to the nondiscrimination rules. Under the bill, if a contract is purchased under a church plan by (1) schools above the secondary level (other than those for religious training) or (2) health care organizations (including hospitals and medical research organizations) which provide community service for inpatient care and not more than 50 percent of total patient days are customarily assignable to certain categories of medical treatment, either the plan or such organization (at the option of the plan) must meet the requirements of sections 401(a)(3) and (a)(6) as in effect on September 1, 1974, 401(a)(4), (5), (17) and 401(m).

The bill defines a contract purchased by a church to include an annuity (sec. 403(b)(1)), a custodial account (sec. 403(b)(7)), and a retirement income account (sec. 403(b)(9) as amended by the bill). A church is defined as a church or a convention or association of churches, including certain organizations described in sections 414(e)(3)(A) and 414(e)(3)(B)(ii).

The vesting requirements that apply for purposes of new section 401A apply for purposes of church plans under section 403(b). Thus, the present-law vesting rules relating to tax-sheltered annuities do not apply (secs. 403(b)(1)(C) and 403(b)(6)). In addition, salary reduction amounts must be nonforfeitable. The rules relating to the failure of one organization to meet the requirements of section 403(b) and the rules relating to highly compensated and excludable employees are similar to the rules applicable under new section 401A.

The bill treats as an employee for section 403(b) purposes certain self-employed (within the meaning of sec. 401(c)(1)(B)) ministers and any other duly ordained, commissioned or licensed minister that is employed by an organization other than an organization described in section 501(c)(3). Thus, these individuals may participate in tax-sheltered annuity programs.

For purposes of applying the exclusion allowance (sec. 403(b)(2)) and the limitations on contributions and benefits (sec.415), any nonvested contribution which is forfeitable is treated as an amount contributed to the contract in the year for which such contribution is made and not in the year the contribution becomes nonforfeitable.

Effective date.--The modifications relating to the purchase of contracts by churches generally are effective for years beginning after December 31, 1989. The vesting standards are effective for years beginning after December 31, 1992.

No regulation or ruling under section 401(a) or 403(b) issued after December 31, 1989, shall apply to a contract purchased by a church unless such regulation or ruling is specifically made applicable to such contracts.

D. Modification of Distribution Requirements

Under present law, an annuity contract is not described in section 403(b) unless distributions do not begin before age 59-1/2, separation from service, death, disability (within the meaning of sec. 72(m)) or (with respect to principal under the contract) in the case of hardship. The bill modifies the definition of disability for purposes of retirement income accounts to conform to the definition used for purposes of the rules relating to cash or deferred arrangements (sec. 401(k)(2)).

Effective date.--The modification is effective for years beginning after December 31, 1988.

E. Modification of Required Beginning Date for Distributions

Under present law, distributions are required for certain retirement programs no later than April 1 of the year following the year in which a participant turns 70 1/2 (sec. 401(a)(9)). With respect to church plans, the required beginning date is the later of the date described in the preceding sentence and April 1 of the year after the year in which the employee retires. Under the bill, the special rule for church plans applies to all church plans described in section 414(e) instead of the present law rule that allows relief only to those churches treated as such for employment tax purposes (secs. 3121(w)(3)(A) and (B)).

Effective date.--The provision is effective as if included in the Tax Reform Act of 1986.

F. Exclusion of Ministers from Nondiscrimination Requirements

The bill adds a new section 414(u) that excludes ministers from being considered when an employer applies the following sections: 401(a)(3), (4) and (5) as those sections were in effect on September 1, 1974, 401(a)(4), 401(a)(5), 401(a)(26), 401(k)(3), 401(m), 403(b)(1)(D), 410, 79(d), 105(h), 120(c)(1), (2) and (3), 125(b), 127(b)(2), and 129(d)(2), (3) and (8).

The church plan in which such minister participates shall be treated as a plan or contract meeting the requirements of section 401(a), 401A, or 403(b) with respect to such minister's participation.

Effective date.--This provision is effective for years beginning before, on, or after December 31, 1989.

G. Aggregation Rules Not to Apply to Churches

The bill adds a new section 414(v) that exempts churches from certain aggregation rules (secs. 414(b), (c), (m), (o) and (t)) that must be applied in order to determine who is the employer for certain nondiscrimination rules and for certain other purposes (secs. 401(a)(3), (4), and (5) as those sections were in effect on September 1, 1974, 401(a)(4), (a)(5), (a)(17), (a)(26), 401(h), 401(m), 410(b), 411(d)(1) and 416).

The exemption is available to church-related organizations except in the case of such organizations that are not exempt from tax under section 501(a) and which have a common, immediate parent.

A church-related organization may make an election to use this provision for itself and other related organizations on or before the last day of the plan year beginning on or after January 1, 1993.

Effective date.--The provision is effective as if included in the provision of P.L. 93-406, P.L. 98-369, or P.L. 99-514 to which the amendment relates.

H. Qualified Retirement Contributions to Include Voluntary Contributions Pursuant to Church Plans

The bill amends the rules relating to individual retirement accounts (sec. 219) to allow ministers to make or to have made on their behalf qualified retirement contributions in a manner similar to the rules relating to qualified voluntary employee contributions that applied under prior law. Amendments are also made to the distribution rules relating to such contributions.

Effective date.--The provision is effective for taxable years beginning after December 31, 1989.

I. Self-Employed Ministers Treated as Employees for Purposes of Certain Welfare Benefit Plans

Under the bill, the special rule (sec. 7701(a)(20)) treating certain life insurance salesmen as employees for the purpose of certain welfare benefit and qualified plan rules is expanded to include self-employed ministers.

Effective date.--The provision is effective for years beginning before, on, or after December 31, 1989.

J. Deductions for Contributions by Certain Ministers to Retirement Income Accounts

Under the bill, if a minister (as defined below) makes a

contribution to a retirement income account, such contribution is treated as though it were made to a tax-exempt pension trust and is deductible to the extent it does not exceed the exclusion allowance applicable to tax-sheltered annuities (sec. 403(b)(2)). Ministers for whom this provision is available include self-employed ministers and certain ministers employed by an organization that is not described in section 501(c)(3).

Effective date.--The provision is effective for years beginning after December 31, 1989.

K. Modification of Rules for Plans Maintained by More than One Employer

Under the bill, a church plan is not treated as a single plan merely because employers commingle assets solely for purposes of investment and pooling of mortality experience.

L. Expansion of Definition of Church for Purposes of Rules Relating to Certain Deferred Compensation Plans

Under present law, eligible deferred compensation plans under section 457 may only be maintained by eligible employers. Churches (as defined in sec. 3121(w)(3)(A)) and certain church-controlled organizations (as defined in sec. 3121(w)(3)(B)) are not eligible employers. The bill expands the definition of churches under this rule to include all churches as defined under new section 401A.

Effective date.--The provision is effective for years beginning after December 31, 1978.

M. Modification to Health Benefits Accounts in Church Plans

Under present law, a pension or annuity plan may provide for the payment of medical expenses through a segregated account (sec. 401(h)). In the case of a key employee, a separate account must be maintained and any additions to the account with respect to such employee are treated as annual additions for purposes of the rules relating to limitations on contributions and benefits (sec. 415). Under the bill, with respect to a church plan maintained by more than one employer, a separate account is not required for an employee who is a key employee solely by reason of being an officer with annual compensation greater than $45,000. The bill also modifies the amount of the annual addition under section 415 with respect to participants of church plans.

Effective date.--The provision is effective for years beginning after March 31, 1984.

N. Modification of Rule Relating to Investment in Contract

The bill grants foreign missionaries the exception to the special rules for computing employees' contributions (sec. 72(f)) currently available only with respect to certain contributions relating to credits for service performed prior to January 1, 1963.

Effective date.--The provision is effective for taxable years beginning after December 31, 1989.

O. Modification of Rule Relating to Elective Deferral Catch-Up Limitation for Retirement Income Accounts

The bill modifies the elective catch-up provisions relating to retirement income accounts by repealing one of the limitations on the amount of such catch-up contribution (sec. 402(g)(8)(A)(iii)).

Effective date.--The provision is effective as if included in the Tax Reform Act of 1986.

P. Church Plans May Annuitize Benefits

Under the bill, a retirement income account, a church plan, or an account comprised of qualified voluntary employee contributions does not fail to meet qualification requirements merely because it pays benefits to participants and their beneficiaries from a pool of assets administered or funded through an organization whose principal purpose is to provide such benefits (described in sec. 414(e)(3)(A)), rather than through the purchase of annuities from an insurance company.

Effective date.--The provision is effective for years beginning before, on, or after December 31, 1989.

Q. Church Plans May Increase Benefits

Under the bill, a retirement income account, a church plan, or an account comprised of qualified voluntary employee contributions does not fail to meet applicable qualifiction requirements merely because it increases benefit payments to participants and their beneficiaries pursuant to a method not described in section 401(a)(9) or the accompanying regulations.

Effective date.--The provision is effective for years beginning before, on, or after December 31, 1989.

R. Exemption for Church Plans from Nondiscrimination Rules Applicable to Self-Insured Medical Accounts

The bill exempts plans maintained by churches (as described in new sec. 401A) from the nondiscrimination rules relating to self-insured medical plans (sec. 105(h)).

Effective date.--The provision is effective for years beginning before, on, or after December 31, 1989.

IV. ISSUES RELATED TO S. 2902

In general

S. 2902 generally consolidates and modifies rules relating to the regulation of retirement and benefit programs maintained by churches and church-related organizations. The bill may be characterized as generally expanding the present-law exemption available to church plans with respect to these rules. The key issue is whether such an expansion is warranted.

Rationale for present-law qualification requirements

The qualification standards and related rules governing retirement and employee benefit programs are designed to ensure that such programs benefit an employer's rank-and-file employees as well as highly compensated employees. They also define the rights of plan participants and beneficiaries and limit the amount of tax benefits accorded to the plan and its benefits. Several of the rules serve to ensure that funds are in fact available at the time they are payable to participants (e.g., funding requirements and fiduciary rules).

Church plans generally are not subject to several qualification rules that were enacted under ERISA (e.g., the minimum coverage rules and the minimum funding rules). However, this exemption generally has not been granted to churches in the area of welfare benefit plans.

Some argue that the rationale behind the present-law exemption is Congressional deference to the First Amendment requirement of separation of church and state. Arguably, this rationale would support the expansion of the existing exemption to other church-related entities and to other areas (e.g., the rules relating to welfare benefit plans).

Others argue that the need to protect participants exists without regard to whether the plan is maintained by a church or church-related entity.

These persons would also argue that in many instances church-related entities are in direct competition with for-profit entities that must meet ERISA restrictions. In such a case, there is a competitive advantage conferred on the church-related organization. The Congress has used this rationale in several areas to limit the exemption for church plans to certain types of church entities. For example, the exemption related to group-term life insurance (sec. 79) is available only with respect to certain organizations (other than hospitals and colleges) described in section 501(c)(3).